

## Internal Revenue Service

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Date:

October 22, 2008

## Legend

Distributing =

DRE 1 =

DRE 2 =

DRE 3 =

FSub 1 =

Controlled =

FSub 2 =

Newco =

Merger Sub =

Country A =

Country B =

Country C =

Country D =

State A =

Exchange =

Business 1 =

Business 2 =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

a =

b =

x =

Dear :

This letter responds to your February 5, 2008, request for rulings on the federal income tax consequences of a series of proposed transactions (collectively, the

“Proposed Transactions”). The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Internal Distribution (defined below): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

### **Summary of Facts**

Distributing, a publicly traded Country A corporation, is a holding company and the parent of a group of domestic and foreign entities. Distributing has a single class of common stock outstanding that is listed on Exchange. Pursuant to a shareholder rights plan (the “Rights Plan”) adopted by Distributing’s Board of Directors in Year 1, each share of Distributing common stock also evidences one preferred share purchase right to purchase Distributing participating preferred stock on the occurrence of certain events generally involving a change in control of Distributing (the “Distributing Purchase Rights”).

As of Date 1, in addition to other third party indebtedness, Distributing had outstanding (i) \$a in aggregate principal amount of convertible notes with maturity dates of Year 2 and (ii) \$b in aggregate principal amount of convertible notes with maturity dates of Year 3 (together, the “Distributing Convertible Notes”). Distributing also currently has outstanding warrants and options to acquire its common stock.

Distributing maintains an Employee Stock Plan pursuant to which Distributing has granted to key employees options to purchase shares of Distributing common stock, restricted stock, restricted stock rights, and stock appreciation rights. Distributing also maintains a Director Stock Plan pursuant to which Distributing has granted to its directors shares of Distributing common stock and stock options.

Distributing owns all of DRE 1, a company formed under the laws of Country B that is treated as a disregarded entity for U.S. federal income tax purposes. DRE 1 is a holding company that owns all of DRE 2 and DRE 3, each a company formed under the laws of Country B that is treated as a disregarded entity for U.S. federal income tax

purposes. DRE 3 is currently a dormant entity with no employees or business activities. DRE 2 owns all of the outstanding stock of FSub 1, a Country C corporation. FSub 1 engages in Business 1, directly and indirectly through its subsidiaries, all of which (in addition to FSub 1) are members of Distributing's separate affiliated group, as defined in section 355(b)(3)(B) (the "Distributing SAG").

Controlled is a State A corporation and the common parent of a consolidated group. Controlled has outstanding a single class of common stock, all of which is owned by Distributing ( $x$  percent directly and  $(100-x)$  percent indirectly through Distributing's ownership of DRE 1). Controlled engages in Business 2, both directly and indirectly through members of its separate affiliated group, as defined in section 355(b)(3)(B) (the "Controlled SAG").

Financial information has been submitted that indicates that the Distributing SAG and the Controlled SAG each has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

In anticipation of the proposed Reorganization (defined below) and Internal Distribution (defined below), Distributing will cause DRE 1 to transfer its interest in DRE 3 to Distributing and will cause DRE 1 to transfer its interest in DRE 2 (which owns all of the stock of FSub 1) to DRE 3. Distributing will then transfer its interest in DRE 3 (which will then own DRE 2, which in turn owns all the stock of FSub 1) to FSub 2, a Country D corporation that is a wholly owned subsidiary of Distributing and a member of the Distributing SAG, in a transaction intended to qualify under section 351. As a result, immediately before the Proposed Transactions, DRE 1's sole asset will be its  $(100-x)$  percent ownership of the stock of Controlled.

### **Proposed Transactions**

For what are represented to be valid business reasons, Distributing desires to realign its corporate structure by forming a new domestic holding company to serve as its parent. Therefore, Distributing, Controlled, and Newco propose the following series of transactions:

- (i) Distributing will form a wholly owned State A corporation, Newco. Newco will have nominal assets and will have a single share of stock outstanding held by Distributing. Newco will become the Distributing group's new U.S. publicly-traded parent as a result of the Proposed Transactions.
- (ii) Newco will form Merger Sub, a transitory State A corporation, for the sole purpose of the merger described in step (iii).
- (iii) Distributing, Newco and Merger Sub each will adopt a plan of reorganization under which Merger Sub will merge with and into

Distributing under Country A law, with Distributing surviving (the “Merger”). In the Merger, the shareholders of Distributing will receive as the Merger consideration voting common stock of Newco in exchange for each share of their Distributing common stock. The nominal share of Newco stock held by Distributing as a result of the initial incorporation transaction will be cancelled. The holders of the Distributing warrants, options and the Convertible Notes will receive Newco warrants, options and convertible notes with identical terms in exchange therefor.

As the result of step (iii) above, Newco will become the parent of Distributing (steps (i) through (iii) collectively, the “Reorganization”). It is anticipated that Newco will assume Distributing’s Rights Plan or adopt a similar shareholder rights plan. Newco also will assume Distributing’s obligations under the Employee Stock Plan and the Director Stock Plan.

- (iv) Distributing will distribute to Newco (a) all of Controlled’s outstanding shares owned directly by it (representing  $\underline{x}$  percent of Controlled’s outstanding stock) and (b) its interest in DRE 1 (which owns  $(100-\underline{x})$  percent of Controlled’s outstanding stock) (together, the “Internal Distribution.”)

Immediately after step (iv) above, Newco will be the new parent of the consolidated group of which Controlled formerly was the common parent.

## **Representations**

The following representations have been made with respect to the Reorganization described above in steps (i) through (iii):

- (a) The fair market value of the Newco stock received by each Distributing stockholder who participates in the proposed Reorganization will be approximately equal to the fair market value of Distributing common stock surrendered by that stockholder in the proposed Reorganization.
- (b) At least 40% of the proprietary interest in Distributing will be exchanged in the Reorganization for a proprietary interest in Newco and will be preserved (within the meaning of Treas. Reg. § 1.368-1(e)).
- (c) There is no plan or intention for Newco or any person related (within the meaning of Treas. Reg. § 1.368-1(e)(3)) to Newco, to acquire, directly or indirectly, any Newco stock issued in the proposed Reorganization. Further, except for payments by Distributing to dissenters who perfect their appraisal rights, neither Newco nor any person related (within the

meaning of Treas. Reg. § 1.368-1(e)(3)) to Newco will have acquired, directly or indirectly, any stock of Distributing with consideration other than Newco stock.

- (d) Distributing has no plan or intention to issue additional shares of stock that would result in Newco losing control (within the meaning of section 368(c)) of Distributing.
- (e) Newco has no plan or intention to liquidate or merge Distributing with and into another corporation, to sell or otherwise dispose of the stock of Distributing, or to cause Distributing to sell or otherwise dispose of any of its assets, except for the transfers under the proposed Internal Distribution.
- (f) Newco and Distributing will each pay their own expenses incurred in connection with the proposed Reorganization. It is not anticipated that the stockholders of Distributing will have any expenses in connection with the Proposed Transactions.
- (g) Newco will acquire Distributing stock solely in exchange for Newco voting stock. For purposes of this representation, Distributing stock redeemed for cash or other property furnished by Newco will be considered as acquired by Newco. Furthermore, no liabilities of Distributing or the Distributing shareholders will be assumed by Newco, nor will any of the Distributing stock acquired by Newco be subject to any liabilities, except that Newco will assume Distributing's obligations under its Employee Stock Plan and Director Stock Plan.
- (h) In connection with the proposed Reorganization, any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Distributing will be converted into an identical right to acquire Newco stock. Subsequent to the proposed Reorganization, there will be no outstanding warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Distributing that, if exercised or converted, would affect Newco's acquisition or retention of control of Distributing, as defined in section 368(c).
- (i) Newco does not own, directly or indirectly, nor has it owned during the past five years, directly or indirectly, any stock of Distributing.
- (j) Following the proposed Reorganization, Newco and Distributing will continue Distributing's historic business or use a significant portion of Distributing's historic business assets in a business.

- (k) No two parties to the proposed Reorganization will be investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (l) Distributing will pay its dissenting stockholders the value of their stock out of its own funds. No funds will be supplied for that purpose, directly or indirectly, by Newco, nor will Newco directly or indirectly reimburse Distributing for any payments to dissenters.
- (m) At the time of the proposed Reorganization, the fair market value of the assets of Distributing will exceed the sum of its liabilities plus the liabilities, if any, to which the assets will be subject.
- (n) The Distributing Convertible Notes are securities within the meaning of section 354(a).
- (o) The Distributing Purchase Rights are the type of rights described in Rev. Rul. 90-11, 1990-1 C.B. 10.

The following representations have been made with respect to the Internal Distribution described above in step (iv):

- (p) The indebtedness, if any, owed by Controlled to Distributing after the Internal Distribution will not constitute stock or securities.
- (q) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (r) No part of the consideration to be distributed by Distributing will be received by a security holder as an employee or in any capacity other than that of a security holder of the corporation.
- (s) The five years of financial information submitted on behalf of Business 1 (as conducted by the Distributing SAG) is representative of the present operations of Business 1 and, with regard to such business, there have been no substantial operational changes since the date of the last financial statement submitted.
- (t) The five years of financial information submitted on behalf of Business 2 (as conducted by the Controlled SAG) is representative of the present operations of Business 2 and, with regard to such business, there have

been no substantial operational changes since the date of the last financial statement submitted.

- (u) Following the Internal Distribution, the Distributing SAG and the Controlled SAG will each continue the active conduct of its respective business, independently and with its separate employees.
- (v) The Internal Distribution is being carried out for the following corporate business purposes: (1) to improve Distributing's and Controlled's access to capital markets, increase funding and strategic flexibility, enhance borrowing capacities and reduce the cost of capital; (2) to improve Controlled's access to U.S. government and private sector contracts; and (3) to allow the management of Distributing and Controlled better to focus their respective efforts on each operation and better to attract and retain key employees. The Internal Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (w) The transaction is not used principally as a device for the distribution of earnings and profits of Distributing or Controlled, or both.
- (x) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Internal Distribution.
- (y) Other than trade account indebtedness created in the ordinary course of business through continuing transactions at terms arrived at by the parties bargaining at arm's length, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (z) Payments made in connection with all continuing transactions between Distributing and Controlled, as the case may be, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (aa) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (bb) For purposes of section 355(d), immediately after the Internal Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Internal Distribution.



- (cc) For purposes of section 355(d), immediately after the Internal Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (1) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Internal Distribution or (2) attributable to distributions on Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Internal Distribution.
- (dd) The Internal Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (ee) No person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or the stock of Controlled immediately after the Internal Distribution who did not hold such an interest immediately before the Internal Distribution.

The following additional representations have been made with respect to the Proposed Transactions:

- (ff) Distributing is not and will not be a passive foreign investment company as defined in section 1297(a).
- (gg) Distributing will not have been a controlled foreign corporation (as defined in section 957) prior to the proposed Reorganization.
- (hh) Distributing will become a controlled foreign corporation (as defined in section 957) as a result of the proposed Reorganization.
- (ii) Controlled is not a United States real property holding corporation, as defined in section 897(c)(2), and had not been a United States real property holding corporation at any time during the five-year period ending on the date of the Internal Distribution.

## Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the Proposed Transactions:

- (1) For federal income tax purposes, the formation of Merger Sub and its merger with and into Distributing pursuant to the Reorganization will be disregarded, and the transaction instead will be treated as the acquisition by Newco of all of the outstanding common stock of Distributing in exchange solely for shares of Newco voting common stock. Rev. Rul. 67-448, 1967-2 C.B. 144.
- (2) The acquisition by Newco of all of the outstanding common stock of Distributing in exchange solely for shares of Newco voting common stock in the Reorganization will be a reorganization within the meaning of section 368(a)(1)(B). Newco and Distributing each will be “a party to a reorganization” within the meaning of section 368(b).
- (3) The Distributing shareholders will not recognize gain or loss on the exchange of their Distributing voting common stock solely for Newco voting common stock in the Reorganization. Section 354(a)(1).
- (4) A holder of Distributing Convertible Notes, warrants, or options, respectively, will not recognize gain or loss upon the exchange of Distributing Convertible Notes, warrants, or options for Newco convertible notes, warrants, or options with identical terms. Section 354(a); Treas. Reg. §1.354-1(e).
- (5) Newco will not recognize any gain or loss upon the receipt of Distributing common stock in exchange solely for Newco voting common stock in the Reorganization. Section 1032(a).
- (6) The basis of the Newco voting common stock received by each Distributing shareholder in the Reorganization will be the same as the basis of the Distributing common stock surrendered in exchange therefor. Section 358(a)(1).
- (7) The basis of the Distributing common stock acquired by Newco in the Reorganization will be determined under section 362(b) taking into account the provisions of section 362(e)(1) and, because the transaction is also described in section 362(a), the provisions of section 362(e)(2).

- (8) The holding period of the Newco voting common stock received by each Distributing shareholder in the Reorganization will include the period during which the Distributing common stock surrendered by such shareholder was held, provided that the Distributing common stock surrendered was held as a capital asset on the date of the exchange. Section 1223(1).
- (9) No gain or loss will be recognized by Distributing on the distribution of the Controlled common stock to Newco in the Internal Distribution. Section 355(c).
- (10) Except for any income inclusion resulting from the application of Treas. Reg. § 1.367(b)-5(a) and (c) (see ruling 16 below), no income, gain or loss will be recognized by Newco on its receipt of the Controlled common stock in the Internal Distribution. Section 355(a)(1).
- (11) Except as modified by ruling 14 below, the aggregate basis of the Distributing common stock and the Controlled common stock in the hands of Newco immediately after the Internal Distribution will be the same as the aggregate basis of the Distributing common stock held by Newco immediately before the Internal Distribution, allocated in proportion to the fair market value of the Distributing common stock and the Controlled common stock in accordance with Treas. Reg. § 1.358-2(a)(2).
- (12) Earnings and profits of Distributing will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. § 1.312-10(b).
- (13) Provided Newco and Controlled are members of the same affiliated group (within the meaning of section 1504(a)(1)) after the Proposed Transactions, the consolidated group of which Controlled was the common parent immediately before the Proposed Transactions will remain in existence after consummation of the Proposed Transactions, with Newco becoming the common parent. See Rev. Rul. 82-152, 1982-2 C.B. 205. Accordingly, the members of the consolidated group will not close their taxable year as a result of the Proposed Transactions, and the continuing group will remain on the taxable year previously employed by Controlled.
- (14) For purposes of Treas. Reg. §§ 1.1502-31 and 1.1502-33, the Proposed Transactions will qualify as a “group structure change.” Notwithstanding the basis allocation required under Treas. Reg. § 1.358-2(a)(2) as described in ruling 11 above, Newco's basis in the Controlled stock immediately after the group structure change will be Controlled's net asset basis as determined under § 1.1502-31(c), subject to the adjustments

described in § 1.1502-31(d). Treas. Reg. § 1.1502-31(b)(2). The earnings and profits of Newco will be adjusted immediately after Newco becomes the new common parent to reflect the earnings and profits of Controlled immediately before Controlled ceases to be the common parent. Treas. Reg. § 1.1502-33(f)(1)).

- (15) The holding period of the Controlled stock received by Newco will include the holding period of the Distributing common stock with respect to which the Internal Distribution is made, provided that the Distributing common stock is held as a capital asset on the date of the Internal Distribution. Section 1223(1).
- (16) The transfer of the Controlled stock by Distributing in the Internal Distribution will be a distribution to which Treas. Reg. §§ 1.367(b)-5(a) and (c) will apply.

### **Caveats**

We express no opinion on the tax effect of the Proposed Transactions under any other provision of the Code or Regulations, or the tax effect of any condition existing at the time of, or effect resulting from, the Proposed Transactions that is not specifically covered by the rulings set forth above. In particular, no opinion is given (and none has been requested) regarding the following:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); and
- (iii) Whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see section 355(e) and Treas. Reg. § 1.355-7).

**Procedural Statements**

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file in this office, a copy of this letter is being sent your authorized representatives.

Sincerely,

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Sean P. Duffley  
Senior Counsel, Branch 2  
Office of Associate Chief Counsel (Corporate)

cc: